

## INTERNATIONAL CITY MANAGERS' ASSOCIATION

1313 EAST 60TH STREET - CHICAGO 37, ILLINOIS

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### FINANCIAL PRACTICES OF SMALL CITIES

What are the good practices applicable to finance administration in small cities, and how should these practices be applied?

Financial planning and current and accurate financial information are essential elements of management in the small as well as the large city, but the chief administrator of the small city is faced with the problem of trying to do a good job in finance administration with little, if any, technical help. The finance officer may be the city manager, the mayor, the city clerk, or an appointed finance director. In some cities an elected clerk and an elected treasurer share or try to share the job.

The best job is done though in those cities where the chief administrator recognizes his technical limitations and sees to it that he has competent help. The city should have a technically trained accountant, although it may be possible to train a clerical employee who has a reasonable degree of aptitude and interest by using the facilities of the state municipal league, the state university, or the state auditor's or public examiner's office. If the mayor or city manager has a general administrative assistant, he can be held responsible for a substantial part of the work in budget preparation and purchasing.

This report sets forth some specific suggestions for finance administration in small cities as related to organization, revenues, property tax assessment, budgeting, accounting, tax and utility billing, purchasing, treasury management, property management, insurance, debt administration, financial reporting and post audit.

Organization. In a small city a combination of city clerk-finance director should be able to handle all accounting ledgers and other financial records as well as personnel records. The chief administrator should supervise budgeting and purchasing but leave the technical phases of accounting to the full-time finance director. The chief administrator must see to it that the financial system provides useful and timely information.

The consolidation of clerical, financial, and personnel activities allows for greater control of these activities than when several persons, either part-time or full-time, are doing some of the work. Operations are simpler and more easily controlled and reviewed with consolidated collections of taxes and fees, composite files and indexes, and full-time employees with one director responsible to the chief administrator. An added advantage is the convenience for the taxpayer of having one central office where he can transact most of his business with the city. It cannot be too strongly emphasized that it pays even in the small city to spend money for one competent accountant who can install and develop the fiscal procedures (including accounting) that will give the chief administrator information and control over financial activities.

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If the city cannot obtain a technically trained accountant, a competent bookkeeper should be designated as finance director. Under this arrangement, however, the chief administrator must do most of the work himself in budgeting, purchasing, and preparation of financial reports.

The finance office may need at least two employees under the finance director. A bookkeeping machine operator can post the accounting ledgers, prepare payroll checks and water utility bills, and keep memorandum records of uncollected taxes. The other employee can act as cashier and do clerical work in checking vouchers and payrolls. The finance director himself can work on assembling the budget, preparing financial reports, and making original accounting entries of a technical nature. The only disadvantage is the lack of internal checks when a wide variety of duties are performed by a small number of employees.

Revenues. The revenue base in the small city generally is limited to property taxes, licenses and permits, fines and fees, and state aid. The chief administrator should look first to the adequate enforcement of present city ordinances as a means of developing city income and then obtain all information and help available from county and state officials. In many states the county does tax assessment work for all territory in the county, including territory within corporate limits of cities. The appropriate state department will furnish information on the probable amount the city can expect from various grants-in-aid. Some state municipal leagues also furnish this kind of information.

Specifically the chief administrator should do the following in analyzing revenue sources and developing a program for recommendation to the city council: (1) Familiarize himself with state revenue laws and city ordinances and make sure that all present revenue sources are being adequately administered. (2) Make sure that every piece of real property in the city is listed including tax-exempt property. (3) Participate in state and regional meetings of city officials to learn what other cities are doing. A strong league of municipalities will help cities in getting permissive legislation for certain types of revenue. (4) Examine other possible sources of revenue, especially the admissions tax and the business license or gross receipts tax. These two taxes are productive in revenue and relatively easy to administer.

Property Tax Assessment. Property tax assessment is hampered by the haphazard selection of assessors, the poor qualifications and lack of training of many assessors, and the low pay for assessment work. It is an important principle to have property tax assessment work done for a large enough area and sufficient property to justify the employment of at least one technically qualified person. In many states the statutes require the county to do property tax assessment for all urban and rural territory within the county borders. If this is so, city officials should work directly with county officials to improve and strengthen assessment practices. Such assistance to the county assessor can be given by the chief administrator, the city engineer, the finance director, and other employees who are familiar with property values and construction methods in the area.

If the city is now doing its own assessing, it is more effective and economical to have the county take over tax assessment on a contractual or service charge basis. If the city must do its own assessment work, it should make every effort to have the assessor trained through the facilities of the state tax commission, the state board of equalization, or other state agency for the guidance and control of local property tax assessments.



Budgeting. Budget preparation in the small city need not be an elaborate operation on the part of the chief administrator, but it should consist of more than copying last year's expenditure figures.

A complete budget program is one of the most important elements of administration in any city regardless of size and should include these prerequisites:

1. A definite budget calendar and budget procedures should be prepared that show the dates of the fiscal year, the date of budget transmittal to the city council, the date of budget adoption, the general content of the budget, and the authority and responsibility for preparing and administering the budget.
2. Simple records should be maintained in all city departments on work activities and regular reports should be sent to the chief administrator. A simple and effective method is to adapt the report forms shown in the ICMA publication, "Monthly Administrative Reports for Cities."
3. A simple and logical classification of accounting funds and revenue and expenditure accounts makes the job of preparing the budget much easier.
4. A long-term capital improvement program (capital budget) enables the city to plan the financing of sewers, parks, buildings, and other capital projects for five or six years in the future. Such a program should allow for the probable increased operating expenses that result from the construction of parks, buildings, and other capital improvements.
5. Continuous management research--a job the chief administrator must do mostly himself, although he can get some help from department heads and from state and national organizations of city officials. Preparing the budget is easier if continuing studies are made of the city services provided, the volume and kind of work required for those services, the equipment and personnel that are needed, the timing of work activities, and the price fluctuations in materials and supplies that are continually used. Every chief administrator, of necessity, does some of this management research but doing it systematically makes the management job easier and more effective.
6. Carefully outlined forms and procedures for compiling and reviewing the budget.
7. Carefully prepared budget documents that include all revenues and all expenditures, including special funds and utilities and city contributions or payments to the school board, the county, and other agencies.

After the budget has been adopted by the city council, the responsibility for administration rests squarely on the chief administrator. Probably the most important part of controlling spending according to the budget or fiscal plan is through a system of allotments. The allotment system forces departments to plan their spending throughout the fiscal year and enables the chief administrator to keep expenditures within appropriations. Allotments are generally established either on a quarterly or monthly basis, but quarterly periods are simpler in preparing allotment schedules and are better suited for small cities.

The finance director working with other department heads can prepare a monthly breakdown of appropriations in memorandum form as a basis for preparing quarterly allotment schedules. The allotment schedules need not be in detail but

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should include summary estimates of expenditures for salaries and wages, contractual services (heat, light, rent, etc.) materials and supplies, and capital outlay (motor vehicles, office furniture, and the like).

Accounting. The most important purpose of an accounting system is the furnishing of information to the chief administrator as a guide in managing the city. This information, of course, is useful to other groups and for other purposes. The city council wishes to see if policies are being followed as reflected by city expenditures. Investors in municipal bonds are interested in the financial condition of the city. The citizens of the community are interested in the financial condition of the city as it relates to probable property tax rates. Other purposes of governmental accounting are to insure the control and legality of expenditures and to provide understandable records that can be used for the post audit.

Certainly an accounting system for a small city should avoid too much "system" but it must have certain characteristics and elements to be a useful tool of management. One of the least understood aspects of governmental accounting is the relationship between the budget appropriations and the accounts themselves. Accounts in form and classification should conform with the budget. The accounts should contain as much detail as the budget and more, if necessary. The careful correlation of budgeting and accounting (or budgetary accounting) provides useful statistical data and makes possible accurate estimates for the next budget. Revenues, for example, should be classified by source so that comparisons can be made between estimated and actual revenues as an aid in budget preparation.

Appropriations made by the city council should not be in such detail as to hamper day-to-day administration of city government activities. One approach is for the city council to appropriate money for each city department (or each city function) on a character basis--current expense, capital outlay, and debt retirement. Within this broad framework more detailed expenditure classifications can be set up for accounting and budgeting. Expenditure records can provide current and accurate information and build up experience and data for compiling future budgets.

Governmental accounting is done by "funds". A fund is a sum of money or other resources, such as taxes receivable and investments in securities, set aside for the purpose of carrying on specific activities or attaining certain objectives. A fund is also a separate fiscal and accounting entity. A self-balancing group of accounts must be provided for each fund, showing the assets and other resources on the one hand, and obligations, surplus, and other credits on the other. The accounts for any fund must show the revenues and expenditures and the receipts and disbursements applicable to that fund.

The number of funds needed by a small city is governed to a large extent by state statutes controlling government finance and by the activities and services rendered by the city. Generally, though, the only funds needed are a general fund, one or more special revenue funds, special assessment funds, bond fund, sinking fund, trust and agency funds, and utility funds. A city may also have working capital (revolving) funds for motor equipment or central stores.

It is important that every governmental unit use double-entry accounting. The double-entry system recognizes that every financial transaction involves at least two accounts, and that each transaction results in the exchange of one value for another value. Double-entry accounting shows the dual effect of



every financial transaction, shows that the accounts must always be in balance, and shows that the combined effect of all financial transactions results in a decrease or increase in the surplus or deficit of each of the various funds.

With the double-entry plan each account has two columns for debits and credits. By custom debits are entered on the left-hand side and credits on the right-hand side. For each debit entry there must be one or more credit entries in an equal amount so that accounts will always remain in balance and so that a balance sheet drawn from these accounts will always show that assets equal liabilities plus surplus (or minus deficit). For small cities a general ledger may be all that is required for recording financial transactions.

There are two principal bases of accounting, cash and accrual, although in practice some combination of the two is frequently found. Under a strict cash basis, revenues are accounted for only when received in cash and expenditures are accounted for only when actually paid. Under a strict accrual basis, revenues are accounted for when earned or in the case of taxes when bills are rendered and expenditures are accounted for as soon as liabilities are incurred.

A modified accrual basis is best for small cities. Under this system all expenditures are recorded when incurred whether or not paid for in cash. Revenues are only recorded, on the other hand, when actually collected in cash and regardless of the year to which the revenues apply. The important principle is to know at any time the actual financial position of the city in terms of obligations as well as actual cash disbursements. The actual financial position of the city can be shown under the modified accrual system by the use of the "reserve" method for uncollected receivables. A 100 per cent "reserve for total taxes" account is used to offset the "estimated taxes receivable" account.

The important classifications of expenditures are by function, activity, organization unit, character, and object. The most important are classification by function and activity. Function is the purpose to be accomplished by the expenditure while activity is the specific type of work to be performed in carrying out a function. Sanitation and waste removal for example is a function composed of several activities, such as street cleaning, garbage collection, waste removal, etc.

The organization unit classification is simply a grouping of expenditures by city departments. It is more readily understood by the city council and the general public but does not lend itself as well to financial reporting because functions and activities may be carried out by several different departments.

Expenditures can be further grouped (under function and activity or under organization unit) by object: that is according to the article purchased or by the service rendered. It is important not to have too much detail in an object classification of accounts. For a small city an object classification need not include more than personal services, contractual services, material and supplies, fixed charges and capital outlays.

Finally, accounts may be grouped by character on the basis of current expense, capital outlays, and debt retirement.

Payroll accounting, which should be relatively simple, has been complicated in recent years by deductions for income taxes, hospitalization insurance, savings bonds, and retirement insurance. In addition, the casual and temporary laborers



employed in many cities complicate payroll accounting. In general, this work can be simplified by department heads using a standard form for preparing payrolls. This form serves as a payroll voucher and when certified by the finance director is a payment voucher for the issuance of pay checks. Such a form can show the name of the employee, gross pay, deductions, net pay, job classification, and time period covered, with space for entering amounts by account classifications. Payrolls can be further systematized by using regular payroll periods, having employees on an annual pay basis, and making payments by check, not cash.

Tax and Utility Billing. Good tax billing includes prompt mailing of tax bills (not the practice of posting a tax list in the city hall) and allowing payments to be made by mail either by personal checks or money orders. When tax bills are mailed and payment is made by check, no receipt is necessary. Utility billing can be simplified by being done on a quarterly basis with the unpaid bills serving as an accounts receivable file. The city should consider using mechanical equipment for the preparation of tax rolls, bills, and utility charges.

It is more economical for the city and more convenient for the taxpayer when billing is done with the county, school district, and any other governments affecting the residents of the city. If the county does property tax assessment and billing, one tax bill should be prepared if possible for county, school district, special district, and city taxes. The city itself should consider using one bill for taxes, utility charges, and refuse collection charges.

Purchasing. The basic records for purchasing include requisitions, purchase orders, quotations received from bidders, and general correspondence. These records are essential if any formal plan of buying is attempted. Two other sets of records that should be maintained are a file of commodity specifications and a set of vendors' catalogs.

The types, sizes, and grades of commodities used by the city should be reviewed and reduced to a minimum. When this has been done, standard specifications available from the federal government and many professional and trade associations can be used for the major items bought by the city. It is not worth the time and expense to standardize items that are used only in small quantities. Instead a listing of various products and brands will serve as a satisfactory basis for bids and the placing of purchase orders.

Gasoline and motor oil and motor vehicles are the largest items in dollar amounts purchased by the small city. It is economical to purchase gas and oil on contract for bulk storage by the city. At the same location, the city can maintain a small repair shop for the routine maintenance of motor equipment. Semi-skilled city employees can be used for motor equipment maintenance--equipment operators, water plant workers, and other general handymen.

It is simpler and more effective for several cities and other jurisdictions to pool their purchasing and thus secure further advantages of quantity buying and lower unit costs. It may be possible for the city to go in with the school district and the county or with neighboring cities.

Purchasing procedures contain certain basic elements that are necessary even in small cities:

1. The purchasing agent should determine the amount and kind of commodities that will be needed. This information can be secured from annual budget



estimates, records of past purchases which suggest probable future consumption, and advance requisitions from departments with estimates of future needs. The National Directory of Commodity Specifications contains references to sources for specifications for practically all of the products that will ever be needed by the small city. These specifications have been developed by many technical and trade associations and federal government departments. The directory is available from the Government Printing Office, Washington 25, D. C., and was compiled by the National Bureau of Standards in 1945 with a supplement issued in 1947.

2. Purchase negotiations to secure competitive prices. The simplest method is to use a simple "Request for Quotation" form that is sent to the appropriate list of vendors. Quotations sometimes can be solicited by telephone calls. Bidders should be requested to quote cash discounts for prompt payment in addition to quantity trade discounts.

3. Awarding orders or contracts to the "lowest and best bidder." Quality and conformance to specifications are important elements as well as price. A "price agreement" can be made with a vendor so that the city does not commit itself to purchase any specific quantity of a particular item. Under a price agreement, a merchant agrees to supply all requirements of the city for a specified commodity during the period of the agreement. The city is not obligated to purchase or accept delivery of any definite quantity of the commodity but furnishes the vendor with an estimate of its probable needs as a guide to the amount that may be purchased during the period of the agreement.

A fixed price may be established for the period of the agreement or a variable price may be established that is a fixed discount from a fluctuating market price. Price agreements bring better and faster delivery and reduce paper work because separate purchase negotiations are not required for each order. Lower unit costs are obtained because prices are based upon the total estimated quantities. Finally, price agreements are particularly good as a means of forestalling emergency purchases.

4. Emergency purchases should have a definite dollar limit--perhaps \$25--and, where practicable, should be made by the finance department.

5. Goods that are delivered should be inspected or checked for quantity and quality. In a small city it is probably simpler to have most goods delivered to one point and inspected by one employee. For certain types of commodities it is difficult if not impossible for the small city to determine whether the specifications have been complied with. State universities sometimes can test commodities on a service charge basis. The National Bureau of Standards has compiled a directory of commercial testing and college research laboratories which shows the types of commodities which each is prepared to test. The directory is available from the Government Printing Office, Washington 25, D. C. Even though the city may not be able to test commodities received, it should at least inspect all deliveries to see that the quantities delivered conform to the quantities ordered.

6. The last element in procurement is a plan for the storage of items that are in continuous use. For the small city these stock items will include mostly stationery and a few repair parts for motor equipment. Purchasing on long-term contracts or "price agreements" eliminates the need for stocking a large variety of goods.

Treasury Management. Treasury management includes the collection of taxes and other revenues, the custody of funds and securities, the disbursement of

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funds, and the maintenance of adequate cash receipt and disbursement records to serve the post audit. In larger cities, the treasurer may also be an important advisor on the investment of city funds and the issuance of bonds.

One employee should be held responsible for the collection of all city revenues although this does not preclude collections by other departments, especially for licenses and library fines. Departmental collections can best be controlled by issuing prenumbered receipt forms. The finance officer should advise the city council in the selection of depository banks, and city funds should be secured by corporate surety bonds or "full faith and credit" governmental securities.

Cash disbursements should be made on a "voucher-warrant-check". Such a form contains a statement of the payee's account, becomes an order or a warrant on the treasurer when signed by the finance director (in many cities the mayor or city manager), and is an order or check on the bank in favor of the payee when signed by the treasurer. Adaptations of this procedure will have to be made for most small cities because one employee probably may be both finance director and treasurer, but the principles are the same: (1) the pre-audit and availability of funds are certified as an accounting function; (2) the order is approved by the treasurer as a legal authorization for releasing the cash; (3) the bank, as custodian of city funds, makes the actual payment of cash on receipt of the order from the city treasurer.

The treasurer's basic records should include a daily collection record of receipts by funds, records showing the cash in each fund, records showing the deposits and balances in bank accounts, records of city-owned securities, and records of disbursements by funds (a warrant or check register). A simple daily statement should be prepared indicating the beginning cash balances in each fund, the receipts and disbursements for each fund, and the cash balance in each fund at the end of the day.

Property Management. The finance director should be given authority and held responsible for maintaining the inventory of city-owned real and personal property. Even in a small city the investment in public property represents a large expenditure. A current inventory of city property is essential not only from the standpoint of knowing what the city owns but also to prevent loss or theft, or to establish proof of loss in case of fire or other destruction. The organization and procedures for establishing and maintaining inventory control over city-owned real and personal property are described in MIS Report No. 73 (February, 1950).

Insurance. Buying insurance is a problem that plagues officials in many cities. Small cities have special problems, however, because the rates are proportionately higher for the risks covered. In addition the city councils in small cities are subjected to a great deal of pressure to divide up the business among local insurance agents. The finance director or the chief administrator should study the risks that should be covered and secure competitive bidding where possible to reduce the cost of insurance. A discussion of reducing municipal insurance costs is contained in MIS Report No. 33 (February, 1947). Good procedures for small cities in buying municipal insurance are described in MIS Report No. 74 (March, 1950).

Debt Administration. A primary problem is securing competent advice and technical assistance in issuing the various kinds of bonds that may be needed by the city. The finance officer in the small city should have a general



knowledge of the purposes for which the city may borrow, when and when not to borrow, the type of borrowing which will best serve a particular purpose, the legal limitations that govern municipal debt, the maintenance of debt records, and the reporting of debt. In some states, the state auditor, treasurer, or other official can give valuable assistance to small cities in issuing bonds. Assistance should be sought from a firm of recognized municipal bond attorneys. Such attorneys can draft resolutions, ordinances, ballots, and official notices, and do other jobs in the numerous and complicated legal steps from the time the voters authorize the issue to the final stages when the bonds have actually been bid on and sold.

Serial bonds are best for small as well as large cities. Serial bonds provide for consistent reduction of debt through serial maturities, eliminate investing of and accounting for sinking fund monies, and reduce the average life of the bond issue. In addition, serial bonds are easier to sell on the investment market.

The city itself must maintain adequate bond records that identify the issue as to purpose, amount, principal and interest requirements, and balances outstanding. A simple record of this kind is essential in preparing complete financial reports.

Financial Reporting. Municipal financial reports are intended primarily for three groups: city administrative officials, the city council, and the general public. Considerable experience on the part of municipal officials has gone into the development of recommendations for the scope, format, and content of various kinds of financial reports. These standards cover in some detail the information that should be shown on the balance sheets and other accounting statements for the general fund and other funds, subsidiary statements, statistical material, etc.

The report should be issued as soon as possible after the time period it covers; it should have a title showing the complete name of the city and the period covered; and it should have a table of contents. The report should have a letter of transmittal or introductory statement of explanation and interpretation of the facts presented. It should have a combined and individual fund balance sheets showing assets and liabilities, reserves, and surplus. Accounting statements should be cross-referenced and numbered and the statements should be arranged in logical order with headings that show the name of the fund, the kind of statement and the date or period covered. It is particularly important in public reports to show the basis of accounting used, whether it is cash, accrual, or modified accrual. It cannot be overemphasized that financial reports of any kind should show what activities are covered, the basis for accounting, the time period covered, the official date of the report, and the full name of the city.

A comprehensive and technical finance report should be prepared at least for the city council and for state regulatory agencies, even if no such report is prepared for the general public.

Post Audit. An independent post audit under the supervision of the city council should be made at least once a year. Such an audit can be made by the state auditor's or public examiner's office, or by independent public accountants. The auditor should be selected by and responsible to the city council, to preserve the principle of legislative review of city finance administration. The auditor should not be selected by competitive bids.

Once an auditor has been selected, it is important that there be a definite understanding as to the scope and detail of the audit to prevent any misunder-

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standing that may arise after the auditor has submitted his report. It is best for the auditor to make a general audit which covers all financial transactions of the city. It may not be necessary, however, for him to make a "complete" general audit. He needs to examine all types of financial transactions, but he may not need to make a personal check of every financial document issued and received by the city. Instead, he may examine each basic type of document on a spot check or sampling basis.

The city may want the auditor to do his work on a continuous basis. Under this plan the auditor drops in from time to time during the fiscal year to check books and records and keep up to date on the fiscal work of the city. He can have his annual audit report ready much more quickly after the close of the fiscal year and is available rather frequently for advice and consultation on accounting and other financial problems.

A good auditor when he submits his report to the council will make suggestions for better finance organization and better internal control of financial transactions. These suggestions can often be very helpful in pointing out the weaknesses in the financial organization of the city and the handling of public funds. If the audit report is well done it can serve as a city's annual financial report.

The Work That Can Be Done. The argument may be advanced that the financial practices and procedures described above are too detailed, voluminous, and complicated for the small city. An answer is that these practices have been adopted at least in part by many small cities in various parts of the United States. For example, one city of 3,000 population in one year's time adopted a detailed account classification of revenues and expenditures conforming to standards of the National Committee on Governmental Accounting; adopted an annual budget conforming to the account classifications; began preparing monthly financial reports; installed tight controls over municipal purchasing, including pre-audit of purchases; began preparing utility bills by machine; prepared property tax ledger cards for each piece of real property; analyzed municipal revenue sources to see what new sources could be developed; arranged for newspaper publicity on tax due dates and penalties; began mailing tax bills; and issued a semi-annual financial report that is published in the local newspaper.

Note: The major elements of financial administration from the management point of view are covered in the training manual "Municipal Finance Administration" (International City Managers' Association, 1313 East 60 Street, Chicago 37. 1949. 491pp. \$7.50). The technical aspects of governmental accounting for small cities are thoroughly covered in the book, "Simplified Municipal Accounting" (Municipal Finance Officers Association, 1313 East 60 Street, Chicago 37. 1950. 162pp. \$3.25).

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